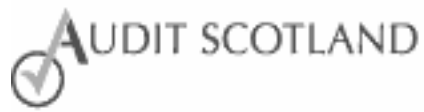


**Lothian and Borders**

**Fire and Rescue Service**

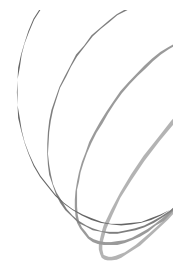
Report to Members on the 2005/06 Audit

31 October 2006



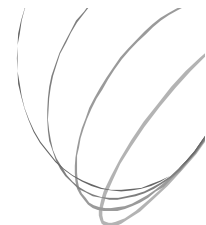
Audit Scotland, on behalf of the Accounts Commission for Scotland, is responsible for:

- providing independent reports to the Commission and the wider public on how public money is spent, what it achieves and what improvements can be made
- providing independent reports to public sector bodies on their finances, their corporate governance and how they manage their performance and secure value for money
- providing an independent opinion on whether the annual financial statements of public sector bodies have been prepared in accordance with statutory requirements



# Contents

<b>Executive summary</b>	<b>1</b>
<b>Introduction</b>	<b>2</b>
<b>Financial statements</b>	<b>3</b>
Auditor's report	
Financial position	
Issues arising	
Legality	
Statement on the system of internal financial control	
Looking ahead	
<b>Corporate governance</b>	<b>6</b>
Overview	
Anti-fraud and corruption arrangements	
Systems of internal control	
Looking ahead	
<b>Performance management</b>	<b>7</b>
HM Fire Service inspectorate	
Modernisation agenda	
Performance indicators	
Looking ahead	



# Executive summary

1. This report summarises the main issues arising from the 2005/06 audit. Overall, the financial stewardship of Lothian and Borders Fire and Rescue Service during the year was satisfactory. Our conclusions on key aspects of the Authority's performance are highlighted in the table below, based on the audit work undertaken during the year and an assessment range of very good, good, fair and unsatisfactory.

<b>Financial statements &amp; financial position</b>	<b>Good</b>
<ul style="list-style-type: none"><li>• The financial statements present fairly the Authority's financial position</li><li>• The Statement on the System of Internal Financial Control complies with accounting requirements and is not inconsistent with audit findings</li><li>• Final accounts preparation procedures &amp; working papers were satisfactory although some presentational changes were made as a result of the audit</li><li>• Balances held at 31 March 2006 were in line with the limits set in the Police and Fire Services (Finance) (Scotland) Act 2001 after ministerial consent, and with the Service's reserves strategy</li></ul>	
<b>Corporate governance</b>	<b>Good</b>
<ul style="list-style-type: none"><li>• Many aspects of a sound corporate governance framework are in place. The Risk Management strategy, introduced in 04/05 is now further embedded within the organisation</li><li>• Audit committee principles and other scrutiny arrangements are being operated effectively</li><li>• A corporate anti-fraud &amp; corruption policy, and procedures and guidance for Public Interest Disclosure are in place</li><li>• Internal Audit concluded that 'reasonable assurance can be placed upon the adequacy and effectiveness of the Board's internal control system in the year to 31 March 2006'</li><li>• The Service has approved Prudential Code Indicators for 2006/07</li></ul>	
<b>Performance management</b>	<b>Good</b>
<ul style="list-style-type: none"><li>• The HM Fire Service Inspectorate followed up their report of February 2005 noting the considerable progress made in implementing all of the recommendations made</li><li>• The Service has issued its Service Improvement plan which, following a period of consultation, was adopted in January 2006</li><li>• All four statutory performance indicators were assessed as reliable for 2005/06</li></ul>	

# Introduction

2. The members and officers of the Service are responsible for the management and governance of the organisation. As external auditors, we review and report on the arrangements in place and seek to gain assurance that:
  - the financial statements have been prepared in accordance with statutory requirements and that proper accounting practices have been observed
  - the Service's system of recording and processing transactions provides an adequate basis for the preparation of the financial statements and the effective management of assets and interests
  - the Service has adequate corporate governance arrangements which reflect the three fundamental principles of openness, integrity and accountability
  - the systems of internal control provide an appropriate means of preventing or detecting material mis-statement, error, fraud or corruption
  - the Service has proper arrangements for securing best value in its use of resources and is complying with its community planning duties
  - arrangements have been made to collect, record and publish statutory performance information
3. This report summarises the most significant issues arising from our work during 2005/06.

# Financial statements

## Auditor's report

4. The financial statements present fairly the Authority's financial position at 31 March 2006 and income and expenditure during the year.
5. The Service's balance sheet has an excess of liabilities over assets of £272.640 million due to an accrual of pension liabilities in accordance with accounting standards. Auditing standards require auditors to consider an organisation's ability to continue as a going concern when forming an opinion on financial statements. One of the indications that may give rise to going concern is an excess of liabilities over assets.
6. The Foreword to the Report and Accounts outlines the treasurer's view that it has been considered appropriate to adopt a going concern basis for the preparation of the financial statements as the accounting requirements for pensions do not impact on the underlying basis for meeting the Service's current and ongoing liabilities. Future pension liabilities will be met, as they fall due, by contributions from constituent authorities in the normal way. We are satisfied that the process the Service has undertaken to consider going concern is reasonable.

## Financial position

7. The Service's net revenue expenditure amounted to £45.769 million in 2005/06 and was met by constituent authorities' contributions of £46.818 million. This Service's surplus for the year was £1.049 million compared to a budgeted surplus of £1.257 million. In his Foreword the Treasurer summarises performance against budget and outlines the major factors contributing to the variance of £0.208 million against budgeted surplus.
8. Capital expenditure totalled £3.143 million and was funded by government grants of £3.123 million and capital receipts of £0.020 million. This expenditure is in line with the Service's Capital Plan for 2005/06.
9. The Service holds a general fund reserve which consists of both earmarked amounts set aside to support future years' expenditure and a contingency for unexpected events or emergencies. Fire boards are limited in how much they can hold in reserves by statute. Earmarked amounts can be held as provision for future commutation liabilities, and the remainder can be set aside within specified limits unless specific consent from Ministers is obtained to hold more.
10. At 31 March 2006, the Service had reserves of £4.283 million, with £3.367 million earmarked to cover particular commitments:
  - £1.278 million set aside to fund future payments of fire pension commuted sums; and
  - £2.089 million earmarked to fund the Service Improvement Plan, which includes the £0.640 million consent received from Scottish Executive ministers to exceed specific consent.
11. The Service's carry forward was within specified statutory limits which included additional carry forward consent of £0.640 million.

## Issues arising

12. The Service's unaudited financial statements were submitted to the Controller of Audit prior to the deadline of 30 June. Final accounts preparation procedures and working papers were satisfactory and this enabled the audit to progress smoothly.
13. Some adjustments were made to the figures included in the unaudited accounts made available for public inspection. In particular:

- the reduction of both debtors and creditors of £508,790 due to the incorrect posting of correcting entries between the accounts
  - an adjustment was made to write back depreciation on assets disposed of in the year. This adjustment increased the net book value of assets by £0.020 million, with a corresponding adjustment to the fixed asset restatement account disclosed
  - the Balance Sheet line 'Balance due to Constituent Authorities' has been removed, and the figures now included within creditors.
14. The issues noted above did not impact on the disclosed surplus for the financial year. Further matters arising from the audit of the financial statements also require to be brought to the attention of members and these are summarised below.

### *Pension liabilities*

15. Accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long, the estimation process is complex and involves many areas of uncertainty that are the subject of assumptions. Financial Reporting Standard 17 (Retirement Benefits) is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future.
16. The fire fighters' pension scheme is unfunded and, therefore, has no assets to be valued. Note 2 to the accounts highlight the present value of scheme liabilities at 31 March 2006 as £289.8 million. The increase from a liability of £239.6 million at 31 March 2005 is in large part due to a change in the financial assumptions used to calculate scheme liabilities. The discount rate used in 04/05 (5.4%) has fallen again (4.9% in 05/06). This lower discount rate resulted in an increase of £28.3 million (56% of the increase) in the Services pension liabilities at 31 March 2006.
17. As the fire fighters' scheme is unfunded, the pension liability will fall to be met by serving fire fighters' contributions and by taxpayers in the future (through constituent authorities' contributions). The government is currently considering major changes to public sector pension schemes, with one of the aims being to provide an affordable, secure and sustainable benefit structure.
18. The Service's estimated pension liabilities for civilian staff at 31 March 2006 exceeded its share of assets in the Lothian Pension Fund by £3.650 million. This represents a steady performance over the year with only a very slight reduction in the deficit, in which the impact of changing financial assumptions has been far smaller than was the case with the unfunded pension liabilities. Based on the full actuarial valuation, an additional employers contribution of £312,000 has been made during the year in respect of benefits already accrued. This contribution will lead to savings of £342,000 over the following three years.

## Legality

19. Each year we request written confirmation from the Treasurer that the Authority's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes and checklists. The Treasurer has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the Chief Fire Officer and the Senior Management Team, the financial transactions of the Service were in accordance with the relevant legislation and regulations governing its activities.
20. There are no additional legality issues arising from our audit which require to be brought to members' attention.

## Statement on the system of internal financial control

21. The 2005/06 financial statements include a Statement on the System of Internal Financial Control which gave the Treasurer's view that reasonable assurance can be placed upon the adequacy and effectiveness of the Authority's internal financial control system.
22. In accordance with good practice, the statement was reviewed by the Authority on 25 August prior to being signed by the Treasurer and is supported by a high level review of the adequacy and effectiveness of internal financial controls undertaken by Internal Audit. The statement complies with accounting requirements and is not inconsistent with the findings of our audit.

## Looking ahead

23. HM Treasury is in the process of introducing Whole of Government Accounts (WGA) covering the whole of the public sector and treating government as if it were a single entity by eliminating all significant transactions between public sector bodies. Local Government (including police and fire and rescue services) is being included in this process in a phased manner:
  - A second 'dry run' in 2005/06 (following on from the initial dry run in 2004/05), involving fuller data collection and a requirement for the data to be subject to audit
  - Production of audited WGA accounts in 2006/07, including prior year comparative figures.
24. Involvement in the WGA process places an additional burden on the Service's finance staff. The service managed this process well during 2004/05, and the 2005/06 return has been completed with no errors identified.



# Corporate governance

## Overview

25. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. Last year we reported that significant improvements had been made over the year. This year has been one of consolidation, embedding the new procedures.
26. Notable progress during the year has been:
  - embedding of Risk Management within the Board;
  - approval of the Integrated Risk Management Service Improvement Plan on 27 January 2006;
  - revision of the Standing Orders in order to comply with the Fire (Scotland) Act 2005.
27. Internal audit plays a key role in the Service's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. The Service's internal audit service is provided by the City of Edinburgh Council under a service level agreement. Each year we undertake an overview of internal audit arrangements which includes an assessment of whether or not we can place reliance on internal audit work in order to reduce our own input.
28. We are pleased to conclude that internal audit work within the Service continues to be of a sufficient standard to allow us to rely on it. However, we noted last year that elements of the internal audit plan had to be carried forward as a result of additional work on the Service's governance arrangements. One such report has been replaced by another piece of work, while the other is ongoing with a view to reporting soon.

## Anti-fraud and corruption arrangements

29. The Service has appropriate arrangements in place to reduce the risk of fraud and corruption. These arrangements include an Anti-Fraud and Corruption Policy and Procedures and Guidance for Public Interest Disclosure.

## Systems of internal control

30. Reliance has been placed on the work of internal audit over the years to evaluate a number of key systems in place within the Service. The Chief Internal Auditor concluded that *'reasonable assurance can be placed upon the adequacy and effectiveness of the Board's internal control system in the year to 31 March 2006'*.

## Issues from previous years

31. Recommendations made in previous years' audit reports are monitored by management and internal audit, with progress regularly reported to the Scrutiny Panel. A report submitted to the Scrutiny Panel in August highlighted that all recommendations due for action had been implemented in respect of both internal and external audit recommendations.

## Looking ahead

32. Internal audit forms an important part of the Authority's internal control arrangements and in ensuring appropriate monitoring of risks and controls takes place. We will seek to take assurance from the work carried out by the Authority's internal audit service during the 2006/07 audit.

# Performance management

## HM Fire Service inspectorate

33. A report following up the February 2005 inspection of Lothian and Borders Fire and Rescue Service was published in November 2005. The aim was to review the progress made against the 12 recommendations made in February.
34. The November follow-up report concluded that:

“Very good progress has been made against each of the 12 recommendations. This is exceptional when considered against a backdrop of maintaining the delivery of the Modernisation Agenda during the same period and, in particular, the extensive consultation exercise undertaken by the Service on the Boards draft Service Improvement Plan. Whilst not forming part of this report this is, nevertheless, perhaps the largest consultation exercise undertaken by any Fire and Rescue Authority in Scotland to date.”

## Modernisation agenda

35. The fire service National Joint Council (NJC) signed a pay and conditions agreement on 13 June 2003. The agreement describes a five-stage pay award, with stages two and three subject to the completion of certain negotiations and the verification by the Accounts Commission that the intended benefits (including savings) of the various national changes are being delivered locally.
36. The Accounts Commissions has issued two national reports in this area in 2004 as part of the first verification exercise. A second verification on the progress of modernisation reported that progress was being made but that it was a long process and there was still significant work to be done before real change would be delivered on the ground.
37. Following from this study, it was agreed to undertake a performance audit on Scottish fire and rescue services during 2006 to include a review of the overall outcomes of modernisation. This work has been ongoing during the year, and the national report is due for publication in February 2007, with a local report to follow.
38. The Service has made significant progress relating to its Integrated Risk Management Plan with the report *Making Safer Communities, Addressing Risk – Service Improvement Plan 2005-20010* approved by the board in January 2006.

## Performance indicators

39. The Service has a statutory duty to collect, record and publish specified performance indicators and, so far as is practicable, ensure that they are accurate and complete. The Accounts Commission issue a Direction each year detailing the indicators that require to be published and external auditors review the Service's arrangements and return details of the indicators, including an opinion on their reliability, to enable compilation of national reports on performance.
40. During the 2004/05 audit we noted issues with the system used to calculate the time taken to handle calls, requiring the figures to be manually recalculated before submission. The system used to generate data in 2005/06 has not changed and this manual recalculation is still required, however I am pleased to report that all indicators prescribed for 2005/06 were classified as reliable.
41. Audit Scotland publish comparative information on performance on its website and all authorities are encouraged to use this information to identify scope for improvement and to contribute to their programme of service reviews. Key points from the 2005/06 statutory performance indicators include:
  - an improvement in the time lost to sickness absence

- a slight worsening of performance in accidental dwelling fires and call response times.
42. Audit Scotland's 2004/05 performance information provided a comparison of all Scottish fire services, including a national average. Lothian and Borders Fire and Rescue Service performed well and in most cases exceeded the national average performance.
  43. In view of the improvements made in 04/05 and the relatively moderate performance in 2005/06, the Service should continue to monitor and review procedures and performance against national trends.

## Issues from previous years

44. Recommendations made in previous years' audit reports are monitored by management and internal audit, with progress regularly reported to the Scrutiny Panel.

## Looking ahead

45. Particular challenges facing the Service in the coming years include:
  - responding to the Efficient Government agenda;
  - continuing the work in relation to the Modernisation Agenda;
  - the implications of the Fire and Rescue Framework issued by the Scottish Executive.
46. These areas are likely to be subject to ongoing review during the 2006/07 audit.